28.10

BITTER

Generic drug makers like Andrx face a barrage of legal and regulatory hurdles put up by big manufacturers intent on protecting their patents as long as they can.

EXPIRING PATENTS

Brand-name patents facing expiration through 2005:

Company	Drug	Year
Abbott Laboratories	Biaxin	2005
AstraZeneca	Zoladex	2005
Aventis Pharmaceuticals	Lovenox	2004
Bayer	Cipro	2003
Bristol-Myers Squibb	Paraplatin	2004
	Pravachol	2005
Eli Lilly	Axid	2002
GlaxoSmithKline	Augmentin	2002
	Relafen	2002
	Flovent	2003
	Flonase	2003
	Engerix-B	2003
	Zofran	2005
Merck	Singulair	2003
	Zocor	2005
Novartis Pharmaceuticals	Lamisil	2004
	Aredia	2005
Pfizer	Diflucan	2004
	Zoloft	2005
	Zithromax	2005
Roche Laboratories	Xenical	2004
Schering-Plough	Claritin	2002
	Intron A	2002
Tap Pharmaceutical	Lupron	2004
	Prevacid	2005

Source: Generic Pharmaceutical Association

By Lisa Gibbs

The number of major prescription drugs that will lose their patent protections between 2000 and 2005? There are 43. Total sales represented by those drugs? Some $49 billion.

Those numbers make Richard Lane's mouth water.

Lane is CEO of Davie-based Andrx Corp., the world's fifth-largest generic drug maker. In massive warehouses in Davie and Weston, Andrx crafts off-brand versions of popular drugs that it sells for as little as 30% of the price of the brand-name originals.

Check out some more numbers: Spending on prescription drugs has more than doubled since 1997, to $154.5 billion, and is expected to rise as much as 14% a year for at least the next three years. Industry analysts expect generics, whose lower prices appeal to both consumers and insurers, to double their share of total pharmaceutical sales to 16% by 2005. "Tremendous opportunity," says Lane.

But if the future's so bright, why has Andrx's stock fallen by more than 75% in the last year? There's one more number that Lane isn't so excited about: 11. That's how many patent infringement lawsuits Andrx faces from large drug companies — so-called Big Pharma firms.

Big Pharma's success at using the intricacies of patent law and federal regulation to delay generic competition has made the generic drug business much more complicated and much less predictable — factors that send investors running.

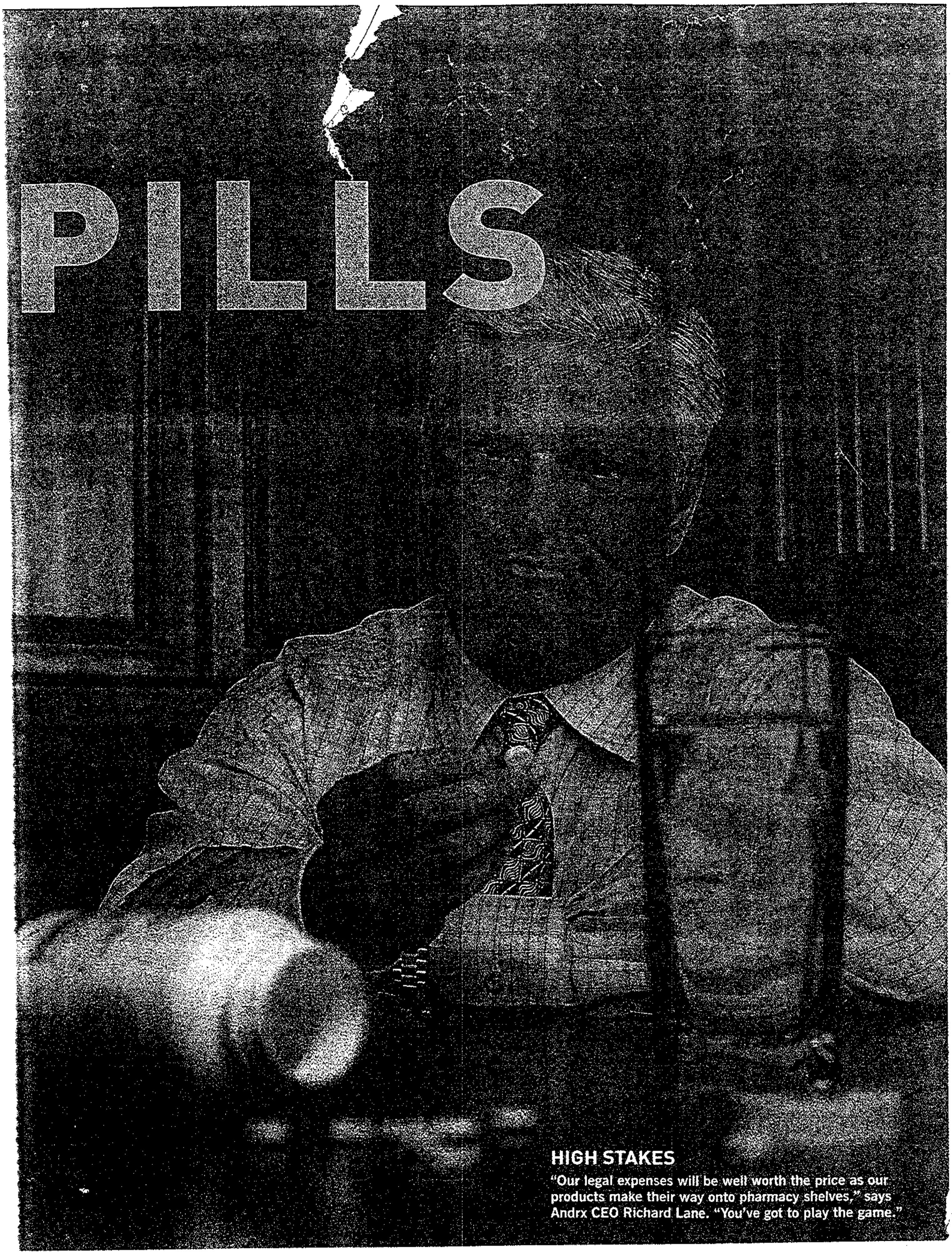
Meanwhile, Andrx and other generic firms must conduct business in a state of perpetual gamesmanship, trying to stay a step ahead of the brand-name drug makers' efforts to protect their products, particularly their blockbuster sellers.

The patent infringement lawsuit is typically the first hurdle for a generic firm attempting to win Food and Drug Administration approval for its copycat version of a Big Pharma product. In recent years, brand-name drug manufacturers have taken to bombarding the FDA with additional patents that sometimes verge on the absurd — patenting a medicine's color, for example — and then filing additional infringement lawsuits against the generic firms' products. (President George W. Bush announced a plan in October to limit Big Pharma's ability to use litigation to delay competition from generics.)

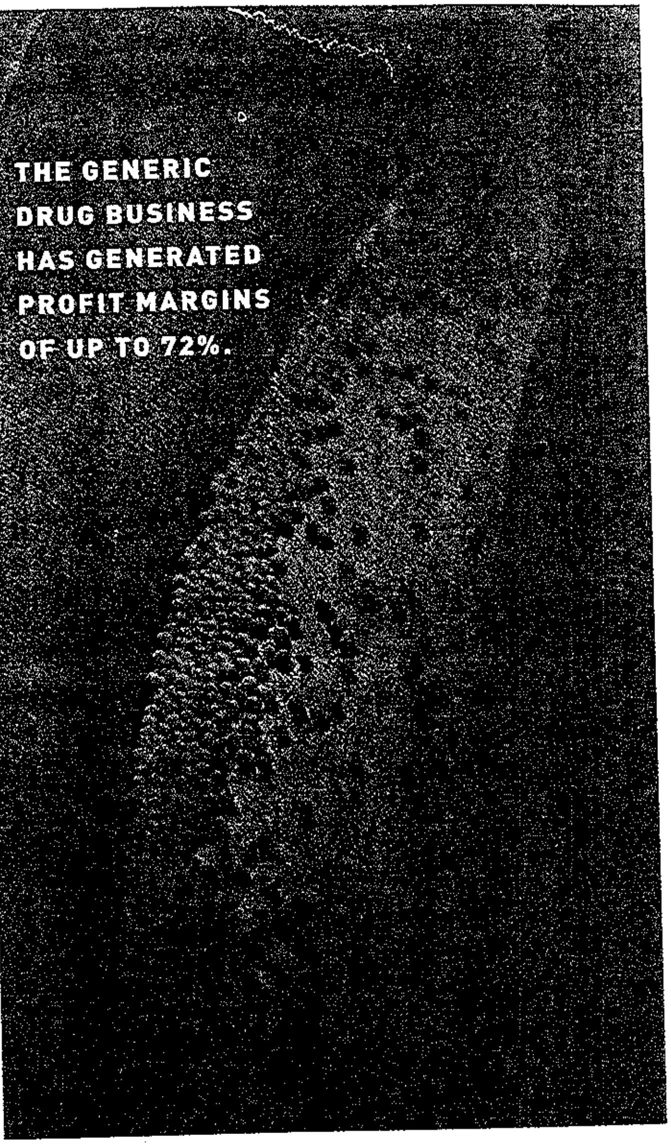
Beyond patent lawsuits, there are several other obstacles. Technically, a generic drug company can market a drug while patent litigation proceeds, but it must have regulatory approvals from the FDA. Gaining those approvals can involve testing products in the same ways the original manufacturer has tested. There are other potential roadblocks: Big Pharma firms can extract another six months of patent protection by testing their products on children, which a feder-

Eileen Escarda

PILLS



HIGH STAKES
"Our legal expenses will be well worth the price as our products make their way onto pharmacy shelves," says Andrx CEO Richard Lane. "You've got to play the game."



al law allows in order to encourage development of drugs for children.

Consider Andrx's battle to sell a generic version of heartburn drug Prilosec, also known as the "purple pill." In 1998, Andrx applied for FDA approval for its generic Prilosec. It had to know that AstraZeneca, the company that makes Prilosec, wasn't going to relinquish the rights gladly. At that time, Prilosec was the world's top-selling drug, bringing in more than $2.3 billion in 1997 sales. But the stakes were also high for Andrx: Analysts estimated that generic Prilosec could generate sales of $500 million for Andrx during the first six months alone.

In May 1998, AstraZeneca sued Andrx for patent infringement. That alone, according to federal law governing the generic business, automatically delayed Andrx's ability to sell the generic for 30 months.

The litigation dragged on much longer than that. The lawsuit didn't even go to trial until December 2001, and the trial lasted well into July. Finally in October, the judge ruled that Andrx had infringed AstraZeneca's Prilosec patent. Andrx plans to appeal the ruling, but the blow sent shares tumbling 40%.

AIMING TO BECOME LESS VULNERABLE TO THE UPS AND DOWNS OF THE COURTS, ANDRX IS DEVELOPING ITS OWN BRAND-NAME DRUGS — AN EXPENSIVE, CUTTHROAT PROPOSITION.

The stock rebounded to more than $18 after Andrx decided to join forces with another company, KUDCo, that prevailed when AstraZeneca sued it for patent infringement over its version of Prilosec.

Unrelenting campaign

Meanwhile, AstraZeneca pursued a campaign against its generic rivals outside the courtroom. In March 2001, it listed four new Prilosec patents with the FDA, prompting Andrx to strike back with its own lawsuit claiming that AstraZeneca was illegally trying to block generic competition.

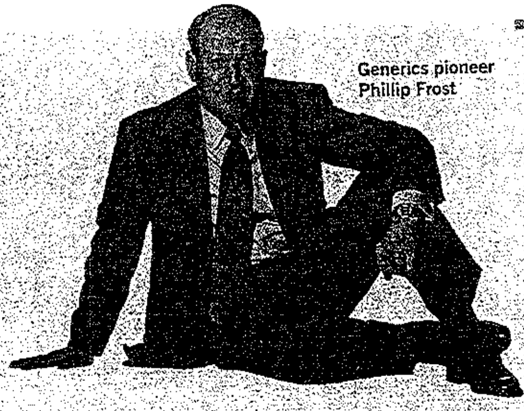
SOUTH FLORIDA GENERICS

Andrx isn't the only, or even the biggest, top-drawer generic firm to call south Florida home. Sixteen years ago, entrepreneurial dermatologist Phillip Frost got rich selling a pharmaceutical company to Schering-Plough. Afterward, he merged several small chemical and pharmaceutical companies into what's now called Ivax Corp. Last year, Miami-based Ivax hit $1.2 billion in sales.

Ivax is something of an Andrx ancestor. Before founding Andrx, Alan Cohen sold a drug distribution business to Ivax and worked there for a while. He then took two top Ivax executives to Andrx with him; one, Elliot Hahn, is now chairman of Andrx. (Cohen left Andrx last year to focus on his newest acquisition, the Florida Panthers hockey team he purchased from Wayne Huizenga.)

In fact, most of south Florida's biomedical and pharmaceutical business communities are related, winding back to three early stalwarts: Frost's first company, Key Pharmaceuticals; stent maker Cordis Corp., bought by Johnson & Johnson in 1996; and Coulter Corp., now part of Beckman Coulter.

Andrx too is retracing Ivax's path when it comes to strategy. Ivax warred for years with a powerful drug maker over a high-profile drug — in Ivax's case, Bristol-Myers Squibb and its breast cancer medicine, Taxol. Ivax also has lessened its reliance on generics. Its branded business, which includes products for allergies and asthma, now represents 43% of revenues.

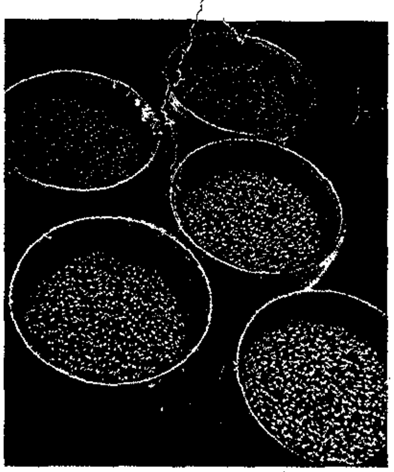


Generics pioneer Phillip Frost

IVAX VS. ANDRX

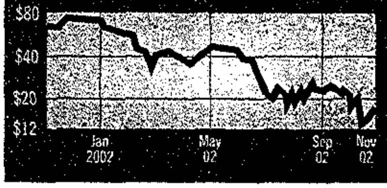
	IVAX	ANDRX
➤ SALES	$1.2 billion	$749 million
➤ PROFIT	$243 million	$37.5 million
➤ R&D SPENDING	$88 million	$53 million
➤ GENERIC DRUG APPLICATIONS PENDING	35	27
➤ EMPLOYEES	8,175	1,837

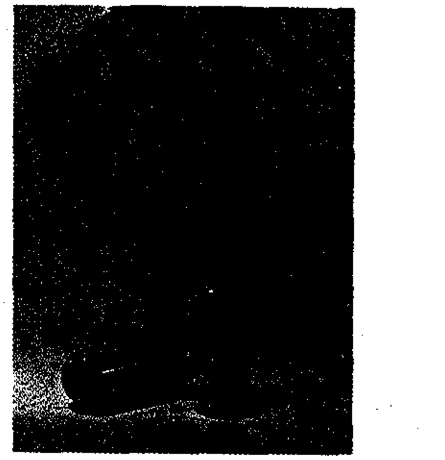
Source: 2001 annual reports



PASS THE ASPIRIN

The path of Andrx's stock over the past year tracks investors' enthusiasm, and then impatience and disappointment, with Andrx's Prilosec prospects. Shares fell 40% after a New York judge ruled against Andrx on Oct. 11.





AstraZeneca also tried to foil rivals by winning FDA approval for new labeling based on an "applesauce test" — it performed a clinical trial demonstrating that patients who find pills hard to swallow can sprinkle Prilosec on applesauce. Doing so meant that generic firms seeking FDA approval would have to conduct applesauce tests on their own pills, introducing further regulatory delays.

Having fought enough similar battles over the years, Andrx had anticipated AstraZeneca's move and already had submitted an applesauce test to the FDA. It won final FDA approval for its drug in November 2001 — four years after applying.

AstraZeneca's most recent tactic to hold onto Prilosec dollars: Winning approval to market the drug over the counter, which would greatly lessen the appeal of an Andrx generic.

Andrx isn't immune to criticism that it's trying to play the system. In 1997 Andrx cut a deal with drug maker Aventis over Aventis' hypertension drug Cardizem: After Aventis sued Andrx for patent infringement, Andrx agreed not to begin selling generic Cardizem while the suit was pending, even after receiving final FDA approval to do so. In return, Aventis paid Andrx roughly $89 million.

Consumer groups, in numerous class-action suits against Andrx, called that "illegal restraint of trade," claiming they could have saved millions had Andrx begun selling its generic sooner.

Andrx denies that; it says the Aventis agreement didn't hurt consumers because Andrx never would have risked selling the generic before resolving the patent lawsuit anyway. (Generic makers who start selling a generic and then lose a patent lawsuit may have to pay damages.) Andrx also said it used Aventis' money to create a different formulation of its drug, thus ending battles between the two companies.

The Federal Trade Commission investigated but found no wrongdoing. Meanwhile, attorneys general from 28 states and the District of Columbia, as well as four Blue Cross Blue Shield insurers, also have sued Andrx over the Cardizem deal. In September, Aventis and Andrx settled some of the claims for $110 million.

Dumping drugs

The impact of the war with Big Pharma imposes other costs beyond the hundreds of millions of dollars in delayed sales. Most obviously, legal fees add millions to Andrx's overhead — it's impossible to say how much, as Andrx doesn't break out those costs. Delays caused by either litigation or the FDA sometimes force Andrx to dump drugs the company had hoped to sell; in the third quarter, Andrx wrote off $41 million in Prilosec-related inventory, putting the company into the red so far this year.

Lane, who arrived at Andrx just five months ago, shrugs off these issues. "You've got to play the game," he says. "Our legal expenses will be well worth the price as our products make their way onto pharmacy shelves."

But Lane also is aiming to make Andrx less vulnerable to the ups and downs of the courts by developing its own brand-name drugs — several featuring an extended-release technology invented by Andrx's former top scientist. Its first branded product, Altocor, is an extended-release version of an off-patent cholesterol drug called Mevacor made by Merck. In addition to Altocor, Andrx is working on an extended-release diabetes drug and studying the use of its extended-release cholesterol drug as a treatment for Alzheimer's.

Ironically, Lane, who for 20 years was a top executive for Merck and Bristol-Myers Squibb (most recently as head of its entire $18-billion pharmaceutical division), led the launch of Mevacor when he was a marketing executive for Merck.

A Wharton MBA with a bachelor's degree in biochemistry, Lane, 51, says he has the skills to move Andrx into the branded business — a big reason Andrx's board hired him. "I've built sales forces for four different companies," he says. "I know what makes brands successful."

Getting into the branded-drug business is an expensive, cutthroat proposition, however, requiring a highly trained and well-paid sales force to push products. Andrx already has built a 300-member sales force and is considering beefing up that staff to 500 within 18 months. The sales team and legal costs are a big part of why administrative expenses nearly doubled in 2001 to $119 million.

Brand-name drugs do require higher "activation energy," as Lane puts it, but if launched successfully, they can drive sales for as long as 10 years. Lane's plan is for those brand-name drug sales to balance the uncertainties of the generic business.

Underpinning Lane's strategy is Andrx's distribution arm, Anda, which sells generic products to about 14,000 independent pharmacies and regional chains. Anda's 2001 profit margins of 17% pale next to the 72% gross margins of the generic business, but it's a cash machine that has helped Andrx fund R&D and litigation without going into debt. "Ideally, we want to complement generics with brands that have longer predictable life cycles," Lane says.

For now, though, Andrx still depends on generics, with a total of 27 awaiting FDA approval or the resolution of lawsuits. "On the generic side," Lane says, "legal is the equivalent of R&D." ❑

More strapped companie

BY ROBERT DODGE
AND VICTOR GODINEZ
DALLAS MORNING NEWS

When Ruby Myers retired as a credit collector from Sears, Roebuck and Co. in 1993, she had no worries about her health insurance.

But health security turned into insecurity as her premiums increased, this year rising to $96 a month from $76. And now, Myers, 78, does not know how she will pay for $3,600 in bills from treatments for ulcers and back pain.

"What I have experienced is that every year the premium will increase or the coverage will change," the Mesquite, Texas, resident said. "Something has changed every year. It's confusing."

Myers is not unique, and many retirees face significantly worse problems. Just last week, retirees peppered Lucent Technologies executives at the company's annual meeting with complaints about cuts in their benefits.

Increasingly, current workers and retirees of major corporations find employers are seeking to reduce their pension liabilities. And one area of costs under renewed attack: retiree health benefits.

"Employers routinely are experiencing double-digit percentage increases in health costs for workers. And the bill for retirees is often outpacing the tab for active workers, because seniors tend to have chronic health problems and are big consumers of ever-more-expensive prescription drugs.

A recent report by the Kaiser Family Foundation and Hewitt Associates found that a decadelong erosion in retiree health benefits is accelerating. And a variety of health benefit experts said the trends are alarming for the 76 million-member baby boomer generation. Many of today's workers may find health coverage has evaporated by the time they retire.

The Kaiser-Hewitt survey of 435 corporations found retiree health benefit costs were rising an average of 16 percent annually. Companies surveyed reported spending an average of $28 million each year on retiree health care.

Companies that provide retiree coverage have often picked up the bill even for employees who leave work before retirement age. About half the burden is picked up by Medicare when seniors turn 65, but employers are left with one of the most costly benefits — prescription drugs.

"Even for employers with the best of intentions, this survey raises concerns about the security of retiree benefits for many workers," said Tricia Neuman, director of Kaiser Medicare Policy Project.

"Employers are really caught between a rock and hard place," she added. "They are trying to limit their own exposure and financial liability. They are trying to maintain their commitment to current retirees. But that may be off for future retirees."

Indeed, the survey found 22 percent plan to eventually dump health coverage for future retirees.

The silver lining is 95 percent of companies plan to continue some level of coverage for existing retirees. Even so, the survey showed that an overwhelming number of companies said they plan to cut benefits and significantly increase the premiums and copayments required of retiree beneficiaries.

In fact, many companies are putting caps on the amounts they will pay for coverage. And when costs rise above the caps, retirees will be asked to pay for 100 percent of the additional expenses.

At most, experts said only a third of workers ever qualified for retiree health coverage because benefits usually were limited to those working for the largest employers. Surveys by the Employee Benefit Research Institute confirm that percentage is likely to decline.

Employers routinely are experiencing double-digit percentage increases in health costs for workers. And the bill for retirees is often outpacing the tab for active workers, because seniors tend to have chronic health problems and are big consumers of ever-more-expensive prescription drugs.

The research group found companies are cutting back on existing coverage, and newly formed enterprises are declining to even begin offering retiree coverage. In fact, a study by consultant Watson Wyatt predicted that by 2031, employers would be paying just 10 percent of individual retiree health expenses.

"Health care cannot continue to be viewed as an entitlement," said Lola Chriss, total compensation and benefits manager for Texas Instruments Inc.

Chriss said Texas Instruments is a good illustration of why companies with big retiree groups can no longer afford the insurance price tag.

She said the Dallas chip manufacturer has 11,500 retirees and 19,500 active U.S. workers. The company spends $142 million on health care, of which $82 million is for retirees.

Texas Instruments plans to continue offering coverage to existing retirees. To get a handle on costs, it placed a cap on how much it would pay annually: $3,000 for

cutting retirees' benefits

early retirees, and $1,500 for beneficiaries who turn 65 and are eligible for Medicare.

"We do not want to see the rug pulled out from under a retiree or active employee," Chriss said. "We will not just stand up and say, 'You are completely on your own.' Absolutely not. That would be a prescription for disaster."

But the company has served notice on employees hired after Jan. 1, 2001. Texas Instruments plans to use its muscle to negotiate favorable rates on health care coverage, but future retirees hired after that date will pay the full bill.

Future retirees of TXU Corp. are facing a similar situation.

Effective Jan. 1, 2002, the electric-generating company said it would not pay for retiree health benefits for employees under age 35. To help workers save more for future medical expenses, the company significantly increased the match to its 401(k) savings plan.

Richard Wistrand, senior vice president for human resources at TXU, said the company has seen health care costs climb 12 percent to 20 percent annually for several years. Between 1997 and 2001, he said health costs jumped 58 percent, with prescription drugs soaring 142 percent.

TXU spent $134 million on health care in 2001; $53 million of that was for its 8,000 retirees.

Like Texas Instruments, TXU plans to use its leverage to negotiate the best insurance rates, but it will be up to future retirees to foot the bill. He said demographic trends at the company demanded that it reduce future costs.

"We will provide the plan and leverage the size of the work force," Wistrand said. "We have very little turnover. The average age at the company is getting older."

Companies such as Texas Instruments and TXU also are trying to hold down health costs through negotiations with providers and innovations like mail-order prescription drug plans.

Still, critics worry that the traditional social contract between employer and worker is under attack, and they are concerned that the nation's employment-based health insurance model may disappear.

"There is a huge fear that this is the tip of the iceberg, that this is the opening sortie on the part of irresponsible employers to get out of the health-care business," said Rick Bank, director of the Center for Collective Bargaining at the AFL-CIO.

Paul Fronstin, a senior research associate at the Employee Benefit Research Institute, said the trend is a frightening development for baby boom workers. He said many boomers have planned on health coverage being available and have not saved to cover the additional costs.

In an upcoming report, the institute shows that a 65-year-old worker retiring in 2003, and who lived to age 85, would need $327,000 in additional savings to cover the lost corporate coverage, Medicare Part B premiums and out-of-pocket expenses.

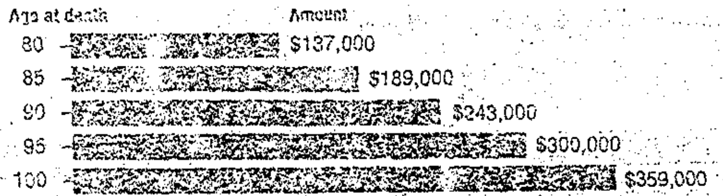
"It's going to be a shock when they see these numbers," Fronstin said. "The baby boomers are much less likely to get retiree health benefits subsidized by their employers. And there is a good chance they will not have access to prescription drugs, even through Medicare."

Myers, the Mesquite resident, is not sure how much of her ulcer and back treatments will be covered by her policy. She has thought about looking for other coverage. But for now, she has taken a part-time job, earning $5.15 an hour, to help supplement her retirement income.

"That plus Social Security is not enough to cover what I have to pay," she said. "It's scary. I don't want charity. I don't want people to take care of me. I want to be able to take care of myself."

Shrinking health benefits

Personal costs: What a person who retired in 2003 at age 65 would pay for a Medigap policy, Medicare Part B premium and out-of-pocket expenses:



Employer costs

Percent increase in employer health care costs, by size of company, 2001-2002:

EMPLOYEES	%CHG.
1,000 - 4,999	+17%
5,000 - 9,999	+17
10,000 - 19,999	+15
20,000 or more	+15

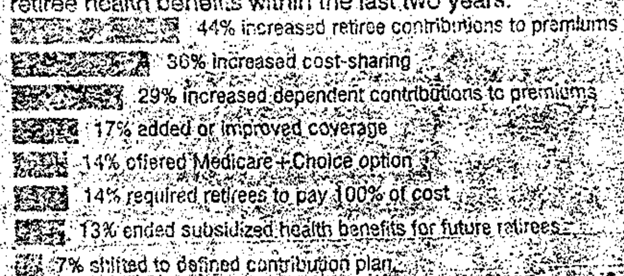
Bigger contributions

Average annual percent increase in employer contributions for new retirees, by size of company, 2001 to 2002:

EMPLOYEES	YOUNGER THAN 65	OLDER THAN 65
1,000 - 4,999	17%	18%
5,000 - 9,999	25	26
10,000 - 19,999	20	23
20,000 or more	23	18

Employer benefit changes

Percentage of large companies that made changes to retiree health benefits within the last two years:



SOURCES: Employee Benefit Research Institute, Kaiser/Hewitt 2002 Retiree Health Survey, December 2002

DALLAS MORNING NEWS

Shoulder the Burde

ging

en

As employer-supported health coverage costs escalate, companies are considering ways to have retirees pay a larger share of the bill.

By Dale Buss

When 17,000 unionized blue-collar employees of General Electric Co. staged a two-day strike in January at 48 plants across the country, they were protesting not only increases in their own health insurance costs but also the $200 or so boost in yearly health coverage costs for GE's 25,000 early retirees.

The GE strike may have been only the start of the difficulties yet to come regarding retiree health coverage. After all, the strikers—mostly production workers—were employees at one of the most stable companies in the country. "It surprised me because GE and the union had a history of being able to talk things out, and the HR team at that company is about as good as you can get," says Charles Tharp, an HR management professor at Rutgers University.

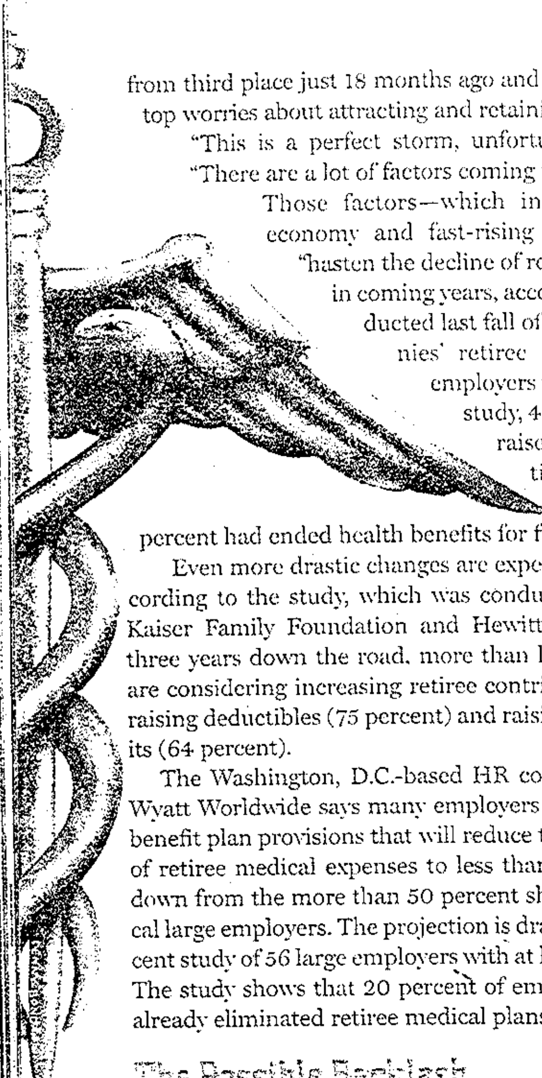
More conflict over retiree health costs will surface in a few months when General Motors Corp. opens triennial national labor negotiations with the United Auto Workers (UAW). It's nearly certain that GM will ask the union for higher co-payments and perhaps other concessions that would affect retirees as well as active workers. But it's almost as likely that the UAW will balk at such demands.

More and more, employers trying to trim their overall health costs are considering ways to shift some costs to retirees who have company-supported health coverage. Options for reducing or even eliminating retiree coverage are gaining attention as the workforce gets older and the ranks of the retired continue to grow. HR professionals at companies that have assumed responsibility for retiree coverage over the years are now wrestling with questions of how much they can continue to provide—and even whether they should provide coverage at all.

"It's really becoming a mission-critical issue for many companies because the underlying trend is that health care costs are going up in the significant double digits, and the biggest portion of that cost is for the older population," says Eric Parmenter, practice leader in health and benefits consulting for Grant Thornton, the Chicago-based accounting and consulting firm. The company's surveys show that retiree medical costs have become the No. 1 concern of HR professionals at large and medium-sized companies, up

DENNY BOHO

'A lot of retirees didn't re
issue would becom
were huge out-of-
particularly fo



from third place just 18 months ago and replacing the former top worries about attracting and retaining employees.

"This is a perfect storm, unfortunately," says Tharp. "There are a lot of factors coming together at once."

Those factors—which include the stagnant economy and fast-rising health costs—could "hasten the decline of retiree health benefits" in coming years, according to a study conducted last fall of large private companies' retiree health coverage. Of employers who responded to the study, 44 percent had already raised the amount that retirees contribute to premiums, and 13 percent had ended health benefits for future retirees.

Even more drastic changes are expected in the future, according to the study, which was conducted by the Henry J. Kaiser Family Foundation and Hewitt Associates. Looking three years down the road, more than half of the companies are considering increasing retiree contributions (82 percent), raising deductibles (75 percent) and raising out-of-pocket limits (64 percent).

The Washington, D.C.-based HR consulting firm Watson Wyatt Worldwide says many employers already have adopted benefit plan provisions that will reduce their financial support of retiree medical expenses to less than 10 percent by 2031, down from the more than 50 percent share now paid by typical large employers. The projection is drawn from the firm's recent study of 56 large employers with at least 5,000 employees. The study shows that 20 percent of employers surveyed have already eliminated retiree medical plans for new hires.

The Possible Backlash

As employers try to reduce their share of retiree health benefits, they may be passing on additional costs to retirees who are already facing significant financial pressures. In fact, for many current retirees and retirement-age employees, health cost concerns are compounded by the tanking of equity markets and retirement nest eggs.

"The financial equation for most people now isn't nearly as good as they thought it would be for the last 20 or 30 years," says Mark White, a senior consultant for Watson Wyatt. "So maybe they end up retiring at 62 instead of 58 and have to use that extra income to help cover the costs of retiree medical benefits."

A couple retiring at 65 and covered by Medicare but not by any other health insurance can expect to spend $160,000 for medical care over the remaining course of their lives, according to Boston-based Fidelity Investments.

Moreover, once retirees start getting health coverage, there's no guarantee that it will always be there. In early February, Pennsylvania-based Bethlehem Steel Corp. became the latest bankrupt company to announce an end to retiree health benefits for financial reasons. The Bethlehem Steel action affects about 95,000 retirees and dependents. The company said it would try to line up discounted group coverage that retirees could buy on their own.

As a result of these financial pressures, companies that trim or eliminate retiree medical coverage can expect retirees to fight back.

"If you try to put more of a burden on them, retirees are likely to poke through and try to find something in your previous dealings with them that indicates you may have promised them something," says David Pearson, a benefits attorney for Orlando-based Ford & Harrison LLP.

Tharp says there may be more agitation by retirees at corporate shareholder meetings for things such as restoration of cost-of-living adjustments, which largely disappeared during the past decade of low inflation.

C. William Jones, executive director of the Association of BellTel Retirees Inc., a Cold Spring Harbor, N.Y.-based group representing 90,000 telecommunications industry retirees, says, "A lot of retirees didn't realize how big this issue would become until this year, when there were huge out-of-pocket increases, particularly for Medicare-eligible people who were in HMOs."

Some analysts expect retiree health coverage to mushroom into a broad political issue.

Jones' association and other groups, including a Washington, D.C.-based coalition called the National Retiree Legislative Network (NRLN), are pushing for legislation that would bring retiree medical coverage under the same kind of federal supervision that exists for many pension plans.

The NRLN says its top priority is legislation designed to "prohibit a company from reducing or taking away health benefits promised and owed to their retirees" and to "require a company to restore health benefits that were previously reduced or taken away after retirement unless a company could demonstrate substantial business hardship."

While some groups are willing to join the fray regarding retiree health benefits, unions—especially those in troubled industries—may not be among them.

"I can't imagine unions having a tremendous amount of power right now when this comes up with airlines, for example," says Paul Fronstin, director of the health-research pro-

'lidhalize how big this contil this year, when there a ot-pocket increases, larr Medicare-eligible people 'ho were in HMOs.'

…team at the Washington, D.C.-based Employee Benefit Research Institute (EBRI).

Tharp says that unions in some industries may be ready to let retirees take the brunt of health-coverage cost shifting "because retirees don't pay union dues or vote on contracts."

An exception could be the auto industry, where labor negotiations this summer could produce a standoff on whether retirees will have to pay more for their health coverage.

If employers face resistance from unions, there may not be much middle ground where the two sides can meet. Retiree health care is not an issue that's likely to be defused by a sharing of information about the dire demands of retiree medical costs, says Parmenter. "It's a fighting issue rather than an understanding that we're all in this together. So I don't know that there's positioning that an employer really can do in a union environment."

When There's No Union to Say No

Companies that aren't restricted by labor contracts can do much more, of course, to corral retiree…

Looming Liabilities

The pressures for capping or curtailing retiree health benefits stem from a decision a decade ago by the Financial Accounting Standards Board. The board, an independent, private-sector organization, decided to require a change in the way companies were handling retiree medical liabilities, which amounted to hundreds of millions of dollars for some major corporations. As a result of the change, such expenses, which were paid as they were incurred, had to be disclosed to shareholders as future liabilities.

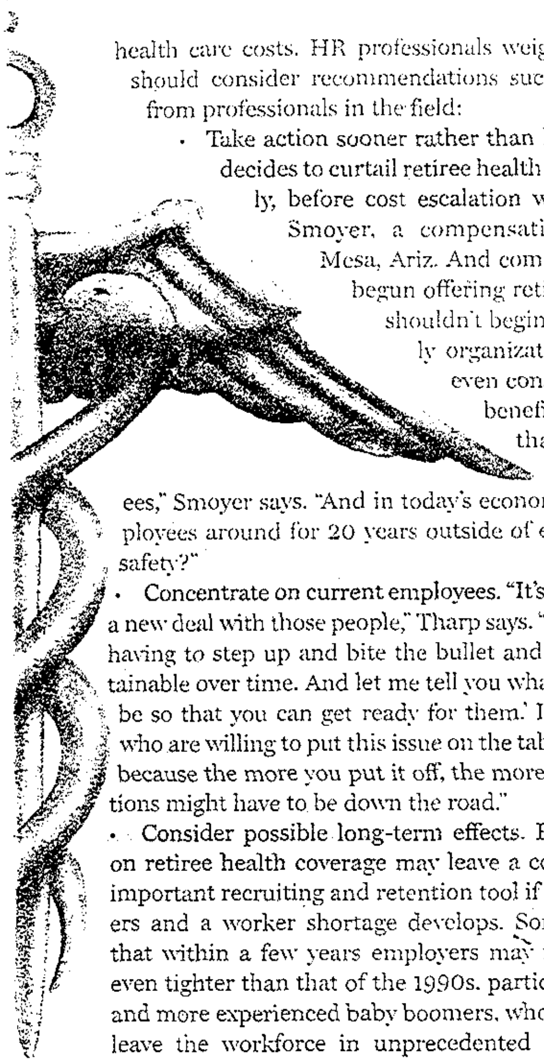
In the auto industry, retiree health care costs and rising pension liabilities are called "legacy costs" and are viewed as multibillion-dollar drains on the bottom lines of companies such as DaimlerChrysler, Ford and GM—traditionally referred to as the Big Three U.S. auto makers. The companies are trying to support retired employees of the industry's golden years with market shares that have shrunk considerably over the decades because of intense foreign competition.

Today, for example, each car rolling off a GM assembly line carries $1,350 in legacy costs—a "penalty" not attached to a Japanese car built in a new, nonunion U.S. plant, says analyst Scott Hill of Sanford C. Bernstein & Co., a New York investment research firm. That cost can be a daunting handicap for manufacturers trying to make an average operating profit of $800 per vehicle.

For the long term, GM believes it can be delivered from this crushing burden only by changes in federal policy. "This is a national issue, and it's going to have to be addressed on a national basis," says Woody Williams, executive director of health care initiatives for GM. "We see costs going up, but again, that's every major employer, that's every state government."

In the meantime, GM is trying various approaches to trim the $4.2 billion it spends each year for health care for [illegible] employees, as well as [illegible] 700,000 retirees and [illegible] dependents connected with its North American operations. The company has full-time "community initiative directors" in five Midwestern metropolitan areas where its employees are concentrated, says Williams. Their responsibilities include identifying hospitals that are the best at handling particular surgical procedures. GM then can save on health costs through volume discounts with such providers, and through better medical outcomes.

GM is also working to reduce its $1 billion annual outlay for prescription drugs; 80 percent is spent for retiree households. The effort includes persuading doctors and hospitals to opt for generic rather than brand-name drugs when possible.



health care costs. HR professionals weighing such options should consider recommendations such as the following from professionals in the field:

- Take action sooner rather than later. If a company decides to curtail retiree health benefits, act quickly, before cost escalation worsens, says Peter Smoyer, a compensation consultant in Mesa, Ariz. And companies that haven't begun offering retiree health benefits shouldn't begin, he adds. "The only organizations [that] should even consider offering these benefits today are those that want to have long-term employees," Smoyer says. "And in today's economy, who wants employees around for 20 years outside of education or public safety?"
- Concentrate on current employees. "It's really about setting a new deal with those people," Tharp says. "Good managers are having to step up and bite the bullet and say, 'This isn't sustainable over time. And let me tell you what the new rules will be so that you can get ready for them.' I applaud managers who are willing to put this issue on the table and talk about it, because the more you put it off, the more draconian your actions might have to be down the road."
- Consider possible long-term effects. Putting the squeeze on retiree health coverage may leave a company without an important recruiting and retention tool if the economy recovers and a worker shortage develops. Some experts suggest that within a few years employers may face a labor supply even tighter than that of the 1990s, particularly among older and more experienced baby boomers, who will be planning to leave the workforce in unprecedented numbers later this decade.

"The number of young people coming in will be shrinking, and lots of companies will be looking to get more out of their existing workers, so encouraging deferred retirements might be a good strategy again," says White of Watson Wyatt. "Companies may need to attract for a while longer those mid-career people who are in their 40s and 50s, to whom health benefits for retirement are going to be increasingly important."

Although clamping a lid on retiree benefits may save money, White says, employers "haven't really gained anything if they have to pump money back into regular compensation to attract and hold people. And you might have lost something because retiree health benefits are tax-protected, whereas regular compensation isn't."

- If reductions are needed, make them incrementally. A company could link the size of its retiree health contributions to each beneficiary's length of service with the company, for example, c limit or even eliminate its contribution according to some ot er measure.

Among the large companies surveyed by Watson Wyatt f example, 90 percent said that in 1984 they offered retiree m ed ical coverage to those over 65 with five or fewer years of ser ice, but by last year only about one quarter of the compani offered benefits to retirees with that length of service. In add tion, about 45 percent of the companies had capped contrib tions for new hires as of last year, while 39 percent had done s for current employees.

An additional possibility is to phase out retiree medical co erage for employees hired after a certain date, whether pas c future. And yet another option is to keep retirees in the co pany's health insurance plan but not pay any portion of the premiums; the discount for the group policy would keep re tirees' health coverage premiums lower than what they woul pay for individual coverage.

But even that approach would not necessarily be benefici for employers because simply having retirees in the compan plan "drives up the cost of insurance," Smoyer says. "That's be cause retirees are the ones [who] have open-heart surgery a bypasses and other complicated, expensive procedures. S hurts the company's experience ratings with insurers."

Another type of employer-set limit is to pick up only th prescription drug portion of a "Medigap" policy—a type of pri vately sold but regulated policy that covers co-payments an other medical expenses not covered by Medicare. Such policie cost companies $3,000 to $4,000 a year for an individua Tharp estimates.

As part of an incremental approach, a company can try t steer retirees—just as they encourage current employees— t opt for generic rather than brand-name drugs when possi le and to use mail-order suppliers for medicines they take regu larly.

- Provide more information. Finally, HR can play a role i containing retiree health costs by providing employees as we as retirees the information they need to manage those costs.

"Companies have invested a tremendous amount of tim and money in telling employees about the need to start earl with their 401(k) program, matching contributions, proper as set allocations—they've taken all those steps," says EBRI Fronstin. "But they haven't done anything like that regarding retirement health care. The next logical step is to educate workers about that."

Online Resources For more information about retiree health care coverage, see the online version of this article at www.shrm.org/hrmagazine

DALE BUSS, A FORMER WALL STREET JOURNAL REPORTER AND NEWSPAPER BUSINESS EDITOR, IS A FREELANCE WRITER IN ROCHESTER HILLS, MICH.

NEW YORK

Employers cutting health benefits

A few days each week, Jody Maxfield and two or three co-workers share lunchtime conversation — and worries about the future.

"That's always the topic of conversation, retirement," says Maxfield, a 42-year-old electrical engineer for Boeing Corp. in St. Louis. "How the company is pulling benefits away from us."

Maxfield said he and others are rankled by a decision to stop subsidizing health insurance for future retirees. By the time he is eligible for retirement in 10 years, Maxfield figures health insurance premiums will claim a substantial portion of his monthly pension check.

A legion of baby boomers could face the question as more companies scrap long-standing commitments to pay for retiree health care.